**FIDELITY DISCOUNTS AND REBATES NOT JUSTIFIED BY THE COSTS: IN WHICH CASES SHOULD A DOMINANT ENTERPRISE BE FORBIDDEN SUCH PRATICES?**

## General Remarks – Abuse of Market Dominance under Swiss Law

Article 7 of the Federal Cartel Act (FCA)[1] deals with abuse of dominant positions. It corresponds almost literally to Article 82 ECT and prohibits practices of dominant firms which prevent other companies from entering or competing in the market or discriminate against trading partners and which cannot be justified by legitimate business reasons (para. 1). As Article 82 ECT, para. 2 of Article 7 FCA enumerates examples of such abusive practices.

According to Article 4(2) of the FCA, dominant firms are defined as one or more undertakings being able, as regards supply or demand, to behave in a substantially independent manner with regards to the other participants (competitors, suppliers and customers) in the market. Hence, the definition of dominant firms is essentially the same as under EC law and practice.[2] Similar to the practice in the European Union[3] and the German Competition Act,[4] the Swiss practice distinguishes between an absolute dominant position and a "relative" dominant position. Market dominance shall not only be determined on the basis of the market structure, but also on the basis of dependencies based on the structure of the market. In particular, market dominance also exists where one undertaking is relatively dominant in comparison to its competitors, or where other undertakings due to the specific structure of the market concerned, are dependent on it.[5]

As the wording of Article 4(2) suggests, Switzerland also recognizes the concept of collective market dominance.

## 1) Definition of fidelity discounts

**The question refers to fidelity discounts. "Fidelity" identifies a sub category of discounts, intended to provide either implicit or explicit compensation for loyalty (you buy only from me). In theory, "fidelity" discounts should be distinguishable from "quantity" discounts, the other sub category of discounts, where a seller provides compensation for large purchases. In practice, the distinction between "fidelity" and "quantity" discounts is much less clear, largely indirect and based on the "objective" justification of the provided discounts. If discounts are objectively justified (strictly cost based) then discount enhances fidelity only indirectly, since the discount passes down to customers the cost reductions originating from the purchase. In such cases discounts are unlikely to be considered fidelity discounts (see also point 2)**

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1 Federal Act on Cartels and Other Restraints of Competition of 6 October 1995, as amended on 1 April 2004 (SR 251).

2 PHILIPP ZURKINDEN/HANS RUDOLF TRÜEB, DAS NEUE KARTELLGESETZ, HANDKOMMENTAR, Art. 4 N 6 (Schulthess 2004), referring to the jurisprudence of the ECJ in Hoffmann-La Roche, C-85/76, or the practice of the EC Commission in Michelin, OJ 2002, L 143, 1.

3 Wernhard Möschel, *Art. 82 EGV N 72, in* WETTBEWERBSRECHT EG TEIL 1 (Immenga & Mestmäcker eds., 4th ed. 2007).

4 ROGER ZÄCH, SCHWEIZERISCHES KARTELLRECHT 278 (Stämpfli 2005).

5 Note also the Commentary of the Federal Council concerning the 2004 revision of the FCA, in OFFICIAL JOURNAL OF THE SWISS CONFEDERATION 2002/1, at 2045.

***1.1 Are you aware of any decision/judgement in your jurisdiction providing a definition of "fidelity" discounts as opposed to other types of discounts? Please describe***

The term fidelity discount is not explicitly defined in the FCA. Rather, it is a term which evolved from the practice of the Federal Competition Commission ("CompComm") under Article 7 of the FCA. In Article 7(2)(b) FCA, practices by dominant undertakings resulting in price discrimination among trading partners, which are not justified by legitimate business reasons, are prohibited. Article 7(2)(d) FCA prohibits price-undercutting targeted against other competitors.

According to the CompComm in *Swisscom ADSL*,[6] it must be distinguished between fidelity discounts and discount schemes which favour a particular undertaking on the downstream market.[7] Fidelity discounts have a similar effect as agreements which require a purchaser to purchase a specific share or all of the goods or services from one dominant supplier,[8] i.e. generate a certain "pull-in" effect in favour of the dominant firm.[9] In general, pure fidelity discounts from dominant firms can be considered unlawful, however a complete assessment needs to be made[10] in order to examine whether or not a discount scheme may be economically justified.[11]

On the other hand, discount schemes which favour particular undertakings on the downstream market (called "preferential discounts"), are considered unlawful where as a result of the thresholds of the different discount bands and the levels of discount offered, only particular undertakings are eligible for the highest discounts, and whereby such discounts cannot be justified with any cost benefit for the dominant undertaking applying them.[12] By the same token, the beneficiaries of the discount scheme receive cost benefits against their competitors allowing them to compete in a "predatory" fashion. As in the above mentioned *Swisscom ADSL* decision independent ADSL providers did not have an alternative to reach their customers other than through Swisscom's network, the CompComm understood the applied discount scheme to be preferential, rather than based on loyalty.

In an earlier case concerning Swisscom,[13] the CompComm prohibited a "pure" loyalty discount scheme, whereby Swisscom granted loyalty discounts to specialist dealers of telecom equipment who procured their equipment in part or fully from Swisscom; under the scheme only those specialist dealers who agreed to a "full-line forcing" were eligible for the highest discounts. The CompComm's finding that this practice was a fidelity discount system with exclusionary effect was later annulled by the Appeals Committee,[14] as the CompComm did not sufficiently establish that the different rebate

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6 Recht und Politik des Wettbewerbs (hereinafter „RPW") 2004/2, pp. 407-448, Swisscom ADSL, at ¶ 142
7 *Id.*, at ¶ 142.
8 *Id.*, at ¶ 143.
9 JÜRG BORER, KOMMENTAR ZUM SCHWEIZERISCHEN KARTELLGESETZ 215 (1998).
10 RPW 2004/2, *supra* note 6, at ¶ 143.
11 *See infra*, answer 2.1.
12 RPW 2004/2, *supra* note 6, at ¶ 144.
13 RPW 1997/4, pp. 506-13, PTT-Telecom Fachhändlerverträge (Telecom-PTT (Swisscom) – Discount Scheme for Specialist Dealers), at ¶¶ 33-38.
14 RPW 1998/4, pp. 655-78, REKO/WEF, PTT-Telecom Fachhändlerverträge (Telecom-PTT (Swisscom) – Discount Scheme for Specialist Dealers (Appeal), at ¶ 5.1-2.

levels had such effect and *de facto* excluded Swisscom's competitors from the relevant market.[15]

## 2) Cost Justification

**The problem is that a cost justification is presumed whenever discounts are directly proportional to quantities purchased in a given period (usually a year). This is not always appropriate. A cost justification may exist if a single order is placed at the beginning of the production period, while deliveries are distributed in the course of the year (reduction of demand uncertainty). A cost justification may also exist if delivery of all quantities purchased occurs in a single instalment (reduction of transportation costs). On the other hand, if the quantity that triggers a discount is achieved by unplanned purchases made in the course of a year, a cost justification is much more difficult to identify.**

### *2.1 Are you aware of any decision/judgement in your jurisdiction discussing evidence of the cost justification underlying a discounting policy? Please describe*

In its decision concerning Swisscom's appeal in the specialist dealers' decision, which concerned Article 7(2)(b) of the FCA, the Appeals Committee held that (fidelity) discount schemes by dominant firms which have the effect to impede a downstream market participant to purchase goods or services from different suppliers are prohibited.[16] However, if such discount schemes are granted as compensation for marketing expenses they seem to be permitted;[17] in other words, discounts are permissible if they relate to "special efforts," i.e. generate certain cost benefits for the dominant firm or reward very good quality of the resellers' work or marketing efforts, but do not limit the downstream market participant in its freedom to organize his product portfolio. As well, discount schemes, such as preferential discount schemes based on volume, may be justified through economies of scale ultimately resulting in cost benefits for the dominant firm.[18]

## 3) Price Discrimination

**"Fidelity" discounts are meant to compensate exclusive purchasing patterns. Therefore "fidelity" discounts are inherently discriminatory. A purchase of 100 units may trigger a discount if the supplier covers all the needs of the acquirer for that particular product, otherwise the acquirer may not receive any discount (and pay a higher price than its competitors). This implies that acquirers of the same quantities may face different prices.**

### *3.1 In your jurisdiction may price discrimination by a dominant firm violate antitrust law? If so, how is this discrimination defined? In particular, is this discrimination*

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[15] *Id*., at ¶ 5.2; in particular, the Appeals Committee held that the CompComm did not establish that the difference of 2% between the highest rebate level (5%) and the next lower level (3%) was sufficient to generate this "pull-in" effect in favour of Swisscom.

[16] RPW 1998/4, *supra* note 14, at ¶¶ 5.1-2. Note the similar position that the CompComm took to the EC Guidelines on the Effect of Trade Concept Contained in Article 81 and 82 of the Treaty, OJ C 101, 27/04/2004 P. 0081-0096: "In the case of exploitative abuses such as discriminatory rebates, the impact is on downstream trading partners, which either benefit or suffer, altering their competitive position [...]." (¶ 74).

[17] RPW 1998/4, *supra* note 14, at ¶¶ 5.1-2.

[18] RPW 2004/2, *supra* note 6, at ¶ 152.

***prohibited per se or only inasmuch as it actually distorts competition in the market? Please describe***

As in Article 82(c) ECT, Article 7(2)(b) of the FCA explicitly declares a discrimination of trading partners with respect to prices or other conditions of trade an illicit trade practice, if it prevents others from entering or competing on a particular market, or if it discriminates among different buyers. Thus, price discrimination is prohibited unless it cannot be justified by legitimate business reasons.[19]

When the Appeals Committee annulled the decision of the CompComm concerning Swisscom's rebate scheme for specialist dealers of telecom equipment, it openly criticized the CompComm for not having sufficiently examined the effect of the rebate scheme.[20]

In the *Swisscom ADSL* case, the CompComm examined whether, in fact, competitors of Bluewin were, as a result of the discounting scheme, prevented from entering and competing in the market.[21]

Accordingly, price discrimination is only prohibited when it actually distorts competition in the market; neither do the examples enumerated in Article 7(2)(b) FCA raise a presumption of an abusive practice, nor do they constitute a *per se* prohibition.[22]

**In most jurisdictions, price discrimination may only be prohibited when put in place by a dominant firm, *i.e.* dominance being a necessary but not sufficient condition for a prohibition. However in some jurisdictions price discrimination may be prohibited also when put in place by non dominant firms.**

***3.2 Are there rules in your jurisdiction that prohibit price discrimination irrespective of the market power of the firm involved? Can you briefly describe these rules and discuss how they are interpreted?***

Article 7(2)(b) FCA only applies to (collectively) dominant firms. Accordingly, unilateral price discrimination of non-dominant firms is not prohibited. However, price discrimination may qualify as a prohibited agreement within the scope of Article 5 FCA.

Article 5 FCA mirrors Article 81 ECT and prohibits any agreements significantly affecting competition and which are not justified by grounds of economic efficiency, as well as agreements which eliminate effective competition. Within the scope of this provision are also agreements concerning vertical distribution systems which include fidelity discount schemes and exclusivity clauses,[23] and which result in a significant impairment of competition.

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19 RPW 1997/4, *supra* note 13, at ¶ 32.

20 RPW 1998/4, *supra* note 14, at ¶ 5.2.

21 RPW 2004/2, *supra* note 6, at ¶ 147.

22 Patrick Ducrey, *Unzulässige Verhaltensweisen marktbeherrschende Unternehmen*, *in* SBVR BAND XI, ALLGEMEINES AUSSENWIRTSCHAFTS- UND BINNENMARKTRECHT (Cottier & Oesch eds., 2007).

23 RPW 2005/1, pp. 114-27, Feldschlösschen Getränke Holding/Coca Cola AG/Coca Cola Beverages AG. Note that the Competition Commission in this case did not find any indication that the agreement resulted in significant impairment of competition.

Horizontal agreements on trade discounts and rebates, as well as uniform calculation schemes, are, of course, also within the scope of Article 5 if their application results in a uniform market price.[24]

## 4) Evidence for Exclusionary Discounting Policy

**Discounts can be exclusionary when they do not allow competitors to profitably compete with the discounting dominant firm. However there are a number of problems associated with this exclusion. The first one relates to the burden of proof. Is indirect evidence (e.g. the fact that competitors market shares were not affected) sufficient to rule out any exclusionary effect?**

### *4.1 In your jurisdiction is indirect evidence that market shares of competitors (and especially market shares of complainants) were not affected by the discounting policy sufficient to rule out its allegedly exclusionary effect? Please describe*

The jurisprudence of the CompComm suggests that indirect evidence that market shares of competitors were not affected by the discounting policy will not suffice to rule out exclusionary effect. A determination that certain behaviour is abusive requires a complete economical analysis.[25] This is due to the fact that the concerned behaviour is often two-faced, having both negative and positive effects on competition. While price competition is desired, it should not result in a strengthening of a dominant position or monopolization.

In *Swisscom ADSL*, Bluewin could lower its prices due to discounts not justified by economies of scale or other legitimate justifications to the detriment of its competitors; in other words, but for the unlawful price discrimination could Bluewin gain relatively more customers than its competitors and therefore increase its market share, and not as a result of it being more efficient than its competitors. Accordingly, the development of the market shares of the concerned undertakings as such was not conclusive as to the exclusionary effect of the applied discount scheme. There must be a causal link between the increase of the market share of the dominant firm and the unlawful discounting scheme.

Equally, stagnant market shares can be the result of discounting dominant firms preventing new competitors from entering the market.

**In order to assess whether a fidelity discounts' strategy is actually exclusionary, competition authorities may need to assess whether the practice is replicable by competitors. Replicability depends on whether matching the pricing strategy of the dominant firm would lead competitors to price below some measure of costs. Therefore, it is necessary to assess whether, as a result of discounts, prices fall below some measure of costs (average variable, average total, incremental or marginal). Furthermore, as for predatory prices, the assessment could be made over the cost of the dominant firm, or, alternatively, over the relevant costs of competitors.**

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[24] BORER, *supra* note 9, Art. 15 N 30.

[25] Evelyne Clerc, *Art.7 LCart N* 66*, in* COMMENTAIRE ROMAND DROIT DE LA CONCURRENCE (Tercier & Bovet eds., 2002) ; *see also*, RPW 2004/2, *supra* note 6, at ¶ 143.

### *4.2 In your jurisdiction is the exclusionary nature of discounts proved through a comparison of costs and revenues? If not, how else is such exclusion assessed?*

A complete competitive assessment is necessary to determine whether a discount scheme has an exclusionary effect.[26] A comparison of cost and/or revenues may form a relevant part of such a competitive assessment. In *Swisscom ADSL*, the CompComm made a comparison of the cost basis of Bluewin and its competitors and concluded that but for the discount favouring Bluewin, Bluewin could offer flat fees for broadband services which were likely below the cost price of its competitors.[27]

In order to determine whether a certain scheme resulted in predatory pricing, the CompComm considers as feasible methods for example, the *Areeda Turner Test*,[28] or a comparison of the sales prices and the average variable costs,[29] as well as a comparison of short and long-term incremental costs.[30]

There are further elements the CompComm takes into consideration when it analyses whether a certain business practice has an exclusionary effect. In *Swisscom ADSL*, the structure of the market was as well an important factor the CompComm considered. Due to the position of Swisscom as a former monopolist in the market, there was almost no alternative available for independent ISPs to reach their customers but through Swisscom's network; further, the market was very fragmented with Swisscom's competitors having an average of only 3300 end-users.[31] According to the Appeals Committee in *PTT-Telecom Fachhändlerverträge*, the effect of the incentive as such must be examined, i.e. whether the incentive in fact generated a "pull-in" effect in favour of the dominant firm.[32] In this case, the Appeals Committee held that it was not established whether the discount scheme had the effect to foreclose Swisscom's competitors access to the market. It held that also quality based discounts can be in conformity with the FCA.[33]

### *4.3 Should your jurisdiction perform a comparison of costs and revenues, what is the definition of costs that is used, average variable, average total, incremental or marginal? Please describe*

There is not sufficient case law in order to provide a general statement.

In *Swisscom ADSL*, the CompComm ruled that discounts are unobjectionable and can be justified when they result in economies of scale, i.e. when they result in a cost benefit for the dominant firm.[34] In this case however, the CompComm found that an increasing number of users of the "Broadband Connectivity Service" only resulted in

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[26] *Supra*, answer 4.1.
[27] RPW 2004/2, *supra* note 6, at ¶ 176.
[28] RPW 2005/1, *supra* note 23, at ¶ 85, referring to Philipp Areeda, Donald Turner, *Predatory Prices and related practice under Section 2 of the Sherman Act*, 88(4) HARVARD LAW REVIEW 679 (1975).
[29] RPW 2005/1, *supra* note 23, at ¶ 85, citing MASSIMO MOTTA, COMPETITION POLICY, THEORY AND PRACTICE 449 (2004).
[30] RPW 2005/1, *supra* note 23, at ¶ 85, citing Patrick Bolton et al., *Predatory Pricing: Strategic Theory and Legal Policy*, 88(8) GEORGETOWN LAW JOURNAL 2239.
[31] RPW 2004/2, *supra* note 6, at ¶¶ 11, 117, 145.
[32] RPW 1998/4, *supra* note 14, at ¶ 5.2; *cf. also*, RPW 2004/2, *supra* note 6, at ¶ 157.
[33] *Id.*, at ¶ 5.2.
[34] RPW 2004/2, *supra* note 6, at ¶ 152.

marginal economies of scale; accordingly the CompComm concluded that the discount scheme could not be justified with economies of scale.[35]

In the *Feldschlösschen/Coca Cola* case concerning the allegedly anticompetitive effects of a contract bottling agreement between the Feldschlösschen Group and Coca Cola, which included a discount scheme the plaintiff Pepsi found to have resulted in below cost gastronomy prices of Coca Cola products and consequently amounted to an abuse of a dominant position by Coca Cola, the baseline to determine whether Coca Cola products were sold below cost were the average total costs and the average short-term costs.[36]

***4.4 Furthermore in your jurisdiction are the relevant costs over which the comparison is undertaken the costs of the dominant firm or the cost of the excluded competitor? In any case are there instances where an above costs abuse was identified in your jurisdiction? Please describe***

The jurisprudence of the CompComm suggests that the cost of the product of the allegedly dominant firm or collectively dominant firms is measured against the cost of the competitive products.[37]

However, as jurisprudence shows, the price the dominant firm offers its goods or services need not be below cost in order to be unlawful. Rather, the decisive factor in a competitive assessment is, whether a certain business practice prevents competitors from entering and competing in the market, or aims at eliminating competition. Equally, a price-undercutting not justified by economies of scale or other legitimate reasons is not *per se* unlawful; the concerned practice must affect the competitors in that they, for example, are forced to compete at below cost prices against the dominant firm.[38]

**The outcome of the replicability assessment depends also on the definition of the sales of the dominant firm which are benchmarked against the relevant measure of costs (total yearly output or some other range). For example, if firms compete for the total demand of a given customer, rivalry occurs at the beginning of the reference period and discounts cannot be predatory in so far as they lead to total revenues above costs. However, if there are asymmetries among firms, in the sense that only the dominant firm can supply total demand by individual customers and its competitors either do not have the capacity to do so, do not have enough reputation so as to satisfy all potential customers, or supply only a limited part of the portfolio of products of the dominant firm, then the relevant measure of sales has to be identified.**

***4.5 In your jurisdiction what is the relevant output over which the exclusionary effect of discounts is calculated and, in the case of bundled discounts, which is the relevant revenue over which the exclusionary effect of discounts is calculated? Please describe.***

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35 *Id.*, ¶ 156.
36 RPW 2005/1, *supra* note 23, at ¶¶ 80, 83, 86-89.
37 RPW 2004/2, *supra* note 6; *see also*, RPW 2005/1, *supra* note 23.
38 RPW 2004/2, *supra* note 6, at ¶ 158.

There is no uniform concept; rather the assessment is made in a case by case basis.

## 5) Justifications for exclusionary discounting policy

**Appropriate consideration might be given to the fact that in a pluralistic market structure (where the number of competitors is greater than two), expansion or new entry is limited by rivalry from all market participants, not just from the dominant firm. In this respect, the record of entry in the industry and the relative movements of market share from year to year should be given proper consideration, in the sense that if there is profitable and extensive entry in the industry in the course of the years practice was in place, the practice itself may not be as exclusionary as expected.**

***5.1 Once a discounting policy is proved to be exclusionary, are there instances where the competition authority accepts justifications by the dominant firm as for the legality of the discounting strategy and if so which justifications have a greater probability of being accepted? Are these justifications relevant for the identification of the abuse, for assessing the level of a possible sanction or for both? Please describe.***

Same as in the ECT, the cardinal concept of the FCA is that the behaviour of the dominant firm must be abusive in order to trigger the application of Article 7 FCA. Consequently, discount schemes of dominant firms are not *per se* prohibited. In Swisscom ADSL, the CompComm held that preferential discount schemes are not prohibited unless the thresholds of the various discount bands and the levels of discount offered in those discount bands only benefit some trading parties, giving them an economic advantage which is not justified by any economies of scale.[39] Further, fidelity discount schemes may be justified when they constitute compensation by the dominant firm for services of the buyer, e.g. when the buyer undertakes to specifically market the product.[40]

Accordingly, behaviour of a dominant firm having exclusionary effects is not prohibited unless it cannot be justified with legitimate business reasons.[41]

## 6) General / Additional comments

***6.1 Does the topic raise any special or additional issue in your jurisdiction, apart from the matters already covered in your answers to the questionnaire?***

No.

***6.2 Any concluding remarks?***

No.

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[39] RPW 2004/2, *supra* note 8, at ¶ 144.
[40] RPW 1998/2, *supra* note 14, at ¶ 5.1.
[41] Commentary of the Federal Council concerning a Federal Act on Cartels and Other Restraints of Competition, in OFFICIAL JOURNAL OF THE SWISS CONFEDERATION 1995/1, at 569.

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